

Mongolia
November 2018

Statement of Audit Needs — Auditor's Terms of Reference

Asian Development Bank

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AUDITOR'S TERMS OF REFERENCE¹

I. INTRODUCTION

1. The Mongolian National Audit Office (MNAO) requires independent auditors to carry out project financial statement audits of the Asian Development Bank (ADB) financed loans and grants for the year ended 31 December 2018 for each of the projects in the lots shown below:

LOT 1		
1	Loan 3287-MON Loan 3288-MON	Agriculture and Rural Development Project - Additional Financing
2	Grant 0236-MON	Fourth Health Sector Development Project: Improving Sector Governance
3	Loan 2932-MON	Fourth Health Sector Development Project - Additional Financing
4	Grant 9189-MON	Managing Soil Pollution in Ger Areas Through Improved On-site Sanitation Project
5	Loan 3313-MON	Regional Upgrades of Sanitary and Phytosanitary Measures for Trade Project
6	Loan 3244-MON Loan 3245-MON	Darkhan Urban Utility Institutional Improvement Action Plan
7	Loan 3072-MON	Payment System Modernization Project
LOT 2		
1	Grant 0240-MON Loan 2719-MON	Regional Logistics Development Project
2	Grant 0315-MON Loan 2934-MON Loan 2935-MON	Urban Transport Development Investment Program-Tranche 1
3	Loan 3086-MON	Food and Nutrition Social Welfare Program and Project - Additional Financing
4	Loan 2963-MON	Fifth Health Sector Development Project
5	Grant 9182-MON	Improving School Dormitory Environment for Primary Students in Western Region
6	Loan 2766-MON	Higher Education Reform Project
LOT 3		
1	Loan 3338-MON	Supporting the Credit Guarantee System for Economic Diversification and Employment Project
2	Grant 0380-MON Loan 3098-MON Loan 3099-MON	Ulaanbaatar Urban Services and Ger Areas Development Investment Program - Tranche 1
3	Loan 3387-MON	Regional Improvement of Border Services
4	Grant 9183-MON	Integrated Livelihoods Improvement and Sustainable Tourism in Khuvsgul Lake National Park
5	Loan 3385-MON	Strengthening Institutional Framework and Management Capacity Project
6	Grant 9187-MON	Strengthening Community Resilience to Dzungar and Forest and Steppe Fires
LOT 4		
1	Loan 2847-MON	Western Regional Road Corridor Development Program - Tranche 1
2	Loan 3129-MON	Western Regional Road Corridor Investment Program - Tranche 2

¹ This statement of audit needs was developed to guide project teams and executing and implementing agencies in communicating the Asian Development Bank's (ADB) auditing requirements to private auditors. This statement of audit needs may also be used as a guide when communicating auditing requirements with supreme audit institutions, where applicable.

3	Grant 0204-MON	Southeast Gobi Urban and Border Town Development Project
4	Loan 3388-MON	Southeast Gobi Urban and Border Town Development Project – Additional Financing
5	Loan 3605-MON	Ensuring Inclusiveness and Service Delivery for Persons with Disabilities
	Grant 9191-MON	Promoting Employment Opportunities for People with Disabilities
6	Grant 9192-MON	Community Vegetable Farming for Livelihood Improvement
7	Loan 3243-MON	Skills for Employment

II. MANAGEMENT RESPONSIBILITY FOR PREPARING PROJECT FINANCIAL STATEMENTS

2. Management is responsible for preparing and fairly presenting the project financial statements, and for maintaining sufficient internal controls to ensure that the financial statements are free from material misstatement, whether due to fraud or error. In addition, management is responsible for ensuring that funds were used only for the purpose(s) of the project, for compliance with financial covenants (where applicable), and for ensuring that effective internal controls, including over the procurement process, are maintained. In this regard, management must:

- (i) Prepare and sign the Audited Project Financial Statements.
- (ii) Prepare and sign a Statement of Compliance.

3. Management must include the following in the Statement of Compliance:

- (i) That project financial statements are free from material misstatements including omissions and errors, and are fairly presented;
- (ii) That the borrower or executing agency has utilized the proceeds of the loan and grant only for the purpose(s) of the project;
- (iii) That the borrower or executing agency was in compliance with the financial covenants of the legal agreement(s) (where applicable);
- (iv) That the advance (formerly known as imprest) fund procedure, where applicable, has been operated in accordance with the Asian Development Bank's (ADB) Loan Disbursement Handbook;
- (v) That adequate supporting documentation has been maintained to authenticate claims stated on the statement of expenditures (SOE), where applicable, for reimbursement of eligible expenditures incurred and liquidation of advances provided to the advance account; and
- (vi) That effective internal control, including over the procurement process, was maintained.

III. OBJECTIVES

4. The objectives of the audit of the project financial statements is to enable the auditor to (i) express an independent and objective opinion as to whether the project financial statements

present fairly, in all material respects, or give a true and fair view of the project's financial position, its financial performance and cash flows, and (ii) provide a reasonable assurance opinion over certain specific representations made in the Statement of Compliance (please refer to paragraph 11).

IV. AUDITING STANDARDS

5. The project financial statement audit is required to be conducted in accordance with International Standards on Auditing (ISA). These standards require that the auditor comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the project financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the project financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the project financial statements whether due to fraud or error. In making those risk assessments, the auditor considers the internal control relevant to the entity's preparation and fair presentation of the project financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the project financial statements.

6. The standards to be applied will be documented in the loan and grant project documents and will include Standards promulgated by the International Auditing and Assurance Standards Board (IAASB): International Standards on Auditing (ISA).

7. In complying with ISA, the auditor will pay particular attention to the following standards:

- ISA 800/ISSAI 1800 – Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks.
- ISA 240/ISSAI 1240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.
- ISA 250/ISSAI 1250 – Consideration of Laws and Regulations in an Audit of Financial Statements.
- ISA 260/ISSAI 1260 – Communication with Those Charged with Governance.
- ISA 265/ISSAI 1265 – Communicating Deficiencies in Internal Control to Those Charged with Governance and Management.
- ISA 330/ISSAI 1330 – The Auditor's Responses to Assessed Risks.

V. PROJECT FINANCIAL REPORTING FRAMEWORK

8. The auditor will verify that the project² financial statements have been prepared in accordance with the International Public Sector Accounting Standards (IPSAS) promulgated by the International Public Sector Accounting Standards Board (IPSASB). The executing agencies and/or project implementation units are responsible for preparing the project financial statements in accrual basis³, not the auditor.

VI. AUDIT DELIVERABLES

A. Content of Audited Project Financial Statements

9. An auditor's opinion providing reasonable assurance over the project financial statements, shall comprise the following:

No.	Accrual-Based Project Financial Statements
1	A statement of financial position (balance sheet)
2	A statement of financial performance (income statement)
3	A statement of cash flows
4	A statement of changes in net assets/equity (where applicable)
5	A statement of advance account (where applicable)
6	Significant accounting policies and explanatory notes
7	A statement of budgeted versus actual expenditures (where applicable)
8	A summary statement of expenditures (where applicable)

10. The auditor's report on the project financial statements should closely adhere to the report formats required by the ISA, but at a minimum should include the following matters:

- a. A title identifying the person or persons to whom the report is addressed;
- b. An introductory paragraph identifying the financial statements audited and the basis of accounting used for preparation of the financial statements;
- c. Separate sections, appropriately headed, dealing with:
 - respective responsibilities of project management (or equivalent persons);
 - auditor's responsibilities for the audit of the financial statements;
 - the basis of the auditor's opinion; and
 - the auditor's opinion on the financial statements.
- d. The manuscript or printed signature of the auditors;
- e. The date of the auditor's report;

² Integrated Budget Law (IBL) 2011, Article 17 indicates that a project unit operated with loans or grants from international organizations and donor countries will be considered a budgetary entity.

³ Article 26 of IBL states that the accrual basis of accounting will be used by the project units.

- f. The auditor's address; and
- g. The emphasis of matter paragraph (where applicable such as financial statements for the prior period were not audited or the financial statements for the prior period were audited by a predecessor auditor⁴).

B. Reasonable Assurance Opinion over the Use of Loan and Grant Proceeds and Compliance with Financial Covenants

11. The auditor will provide a reasonable assurance opinion following ISAE 3000 "Assurance Engagements other than Audits or Reviews of Historical Financial Information" for the following confirmations provided by Management in the Statement of Compliance:

- (i) That the proceeds of the loan and grant were used only for the purpose(s) of the project; and
- (ii) That the borrower or executing agency was in compliance with the financial covenants of the legal agreement(s), where applicable.

12. The auditor will outline the degree of compliance for each of the financial covenants in the loan and grant agreements.

C. Management Letter

10. The auditor will provide a management letter containing, at a minimum, the following:

- (i) Any weaknesses in the accounting and internal control systems that were identified during the audit, including any irregularity in the use of the advance fund and statement of expenditures (SOE) procedures (where applicable);
- (ii) Any identified internal control weaknesses related to the procurement process such as, over the bidding, evaluation and contract management domains;
- (iii) Recommendations to rectify identified weaknesses;
- (iv) Management's comments on the audit recommendations along with the timeframe for implementation;
- (v) The status of significant matters raised in previous management letters;
- (vi) Any other matters that the auditor considers should be brought to the attention of the project's management; and
- (vii) Details of any ineligible expenditure⁵ identified during the audit. Expenditure is considered ineligible if it refers to (i) expenditures incurred for purposes other than the ones intended under the legal agreement(s); (ii) expenditures not allowed

⁴ ISA 510/ISSAI1510 – Initial Audit Engagements

⁵ If the auditor reports any ineligible expenditure in the management letter, the details of the findings should include the funding source to which the observation relates.

under the terms of the legal/financing agreements; and (iii) expenditures incurred in violation of applicable government regulations.

D. Specific Considerations

11. The auditor will, during the course of the audit, pay particular attention to the following:
- (i) The use of external funds in accordance with the relevant legal and financing agreements;
 - (ii) The provision of counterpart funds in accordance with the relevant agreements and their use only for the purposes intended;
 - (iii) The maintenance of proper books and records;
 - (iv) The existence of project fixed assets and internal controls related thereto;
 - (v) Where the audit report has been issued under ISA 800 or ISSAI 1800, it shall include the mandatory Emphasis of Matter paragraph alerting users of the audit report that the project financial statements are prepared in accordance with a special purpose framework and that, as a result, the project financial statements may not be suitable for another purpose. The auditor shall include this paragraph under an appropriate heading;
 - (vi) Where reasonable assurance has been provided using ISAE 3000 or ISSAI 4200, the assurance report must contain, among others:
 - A statement that the engagement was performed in accordance with ISAE 3000;
 - Subject matter;
 - Criteria for measurement;
 - A summary of the work performed; and
 - The auditor's conclusion.
 - (vii) On the advance fund procedure (where applicable), audit procedures are planned and performed to ensure (a) the advance account (and any sub-accounts) has been managed in accordance with ADB's Loan Disbursement Handbook, (b) the cash balance of the advance account (and any sub-accounts) is supported by evidence, (c) the expenditures paid from the advance account (and any sub-accounts) comply with the approved project purpose and cost categories stipulated in the loan and grant agreements, and (d) the amount of expenditures paid from the advance account (and any sub-accounts) comply with disbursement percentages stipulated in the loan and grant agreements;

- (viii) Adequate supporting documentation has been maintained to authenticate claims stated in the SOE for reimbursement of eligible expenditures incurred and liquidation of advances provided to the advance account (where applicable);
- (ix) On the SOE procedure (where applicable), audit procedures are planned and performed to ensure that (a) the SOEs have been prepared in accordance with ADB's Loan Disbursement Handbook, (b) the individual payments for expenditures stated in the SOE are supported by evidence, (c) the expenditures stated in the SOEs comply with the approved project purpose and cost categories stipulated in loan and grant agreements, and (d) the amount of expenditures stated in the SOEs comply with disbursement percentages stipulated in the loan and grant agreements; and
- (x) Any weaknesses in internal controls over the procurement process.

12. All reports must be presented in the English and Mongolian languages within 6 months following the end of the fiscal year and submitted to ADB and executing agencies and/or project implementation units on or before **30 June 2019**.

13. Public disclosure of the project financial statements, including the auditor's opinion on the audited project financial statements, will be guided by ADB's Public Communications Policy (2011). After review and acceptance, ADB will disclose the audited project financial statements and the opinion of the auditor on the audited project financial statements no later than 14 calendar days of ADB's confirmation of their acceptability by posting them on ADB's website. The management letter and the additional auditor's opinions will not be disclosed⁶.

VII. OTHER MATTERS

A. Statement of Access

14. The auditor will have full and complete access, at all reasonable times, to all records and documents including books of account, legal agreement(s), bank records, invoices and any other information associated with the project and deemed necessary by the auditor.

15. The auditor will be provided with full cooperation by all employees of the executing agencies and the project implementing units, whose activities involve, or may be reflected in, the annual project financial statements. The auditor will be assured rights of access to banks and depositories, consultants, contractors and other persons or firms hired by the employer.

B. Independence

16. The auditor will be impartial and independent from any aspects of management or financial interest in the entity or project under audit. In particular, the auditor should be independent of the control of the entity. The auditor should not, during the period covered by the audit, be employed by, or serve as director for, or have any financial or close business relationship with the entity. The auditor should not have any close personal relationships with any senior participant in the

⁶ This type of information would generally fall under public communications policy exceptions to disclosure. ADB. 2011. *Public Communications Policy*. Paragraph 97(iv) and/or 97(v).

management of the entity. The auditor must disclose any issues or relationships that might compromise their independence.

C. Auditor Experience

17. The auditor must be authorized to practice in the country and be capable of applying the agreed auditing standards. The auditor should have adequate staff, with appropriate professional qualifications and suitable experience, including experience in auditing the accounts of projects or entities comparable in nature, size and complexity to the project or entity whose audit they are to undertake. To this end, the auditor is required to provide curriculum vitae (CV) of the personnel who will provide the opinions and reports, together with the CVs of managers, supervisors and key personnel likely to be involved in the audit work. These CVs should include details of audits carried out by these staff, including ongoing assignments.

D. Timeframe

18. The audit assignment is expected to commence on or about February 15, 2019 and be completed on 30 June 2019 for audit of project financial statements of the fiscal year 2018. The auditor is required to address comments provided by ADB on audited project financial statements in timely manner.

E. Audit Service Agreement and Possible Extension

19. The audit service agreement will be signed between the MNAO, auditor and project implementation units. The MNAO and ADB will evaluate the auditor's performance annually. The auditor's satisfactory performance may result to a possible extension of length of audit service period up to five consecutive years for the same loan and grant projects in accordance with the State Audit Law of Mongolia. In such case, the audit service agreement will be renewed on annual basis.